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No.....

Supreme Court of the United States

October Term, 1941

EVERGREEN FARMS COMPANY

Petitioner

VS.

WILLACY COUNTY WATER CONTROL &
IMPROVEMENT DISTRICT NO. 1

Respondent

Petition For Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

---

MAY IT PLEASE THE COURT:

The petitioner, Evergreen Farms Company, a partnership composed of R. E. Harding, W. A. Harding and wife, L. V. Harding, E. B. Burton, a widow, Charles N. Young and Lewis Burton, respectfully show to this Honorable Court:

A.

Summary Statement of Matter Involved

This case involves the right of set-off under Section 68 of the Bankruptcy Act, of mutual debts existing between the bankrupt and a creditor at the time of the filing of a petition in bankruptcy in a proceeding under Title IX (Municipal Bankruptcy Act), of the Act, where a revision of the debt is actually consummated.

At the time of the filing of the bankruptcy petition, the petitioner was indebted to the bankrupt in the sum of $7,019.66 (R-30), and the bankrupt was indebted to petitioner in an amount of ~~$4,707.74~~ 3,538.45 (R-187 Interlocutory Decree of District Court approving plan and disallowing set-off). Mutuality existed since the amount owed by petitioner to the bankrupt was payable into the Maintenance and Operation fund of the debtor,[1] and the amount owed by the debtor

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1—Art. 7880-103, Revised Civil Statutes of Texas, creates a Maintenance Fund for Water Control and Improvement Districts as follows:

> "Such district shall have a fund to be known as the "Maintenance Fund" into which shall be paid all funds collected by assessment or otherwise of the maintenance, repair and operation of the properties and plant of the district, or for temporary annual rental due to the United States. Out of said fund shall be paid all expenses of maintenance, repair and operation of the district, except the expenses of assessing and collecting taxes for the interest and sinking fund may be paid out of that fund. Out of said fund may be paid all expenses not herein otherwise provided for. (Acts 1925, 39th Leg., ch. 25, p. 115, Sec. 103.)"

Art. 7880-102, Revised Civil Statutes of Texas, provides for a Construction Fund into which is payable all moneys derived from the sale of bonds of the district, to be used only for construction purposes.

Art. 7880-94, Revised Civil Statutes of Texas, creates the Interest and Sinking Fund into which is payable all taxes collected for the purpose of paying off the bonded indebtedness of the district, and it may be used only for that purpose.

to the petitioner was payable only out of such Maintenance and Operation fund. The claim of the creditor against the debtor was one assigned to petitioner by one of its partners as a part of the assets of petitioner at its organization, nine months prior to the filing of the petition in bankruptcy. Evidence upon this fact is undisputed (R-16), and the claim was approved by the District Court (R-187). The claim of petitioner against the debtor was for expenses incurred by W. A. Harding, one of the partners of petitioner, in connection with the procuring of a loan to the debtor from P. W. A. of approximately $4,000,000.00. No evidence was offered to dispute or contest the validity or amount of either of the claims, nor was there any evidence offered to contradict or dispute the assignment of the claim to petitioner.

The petitioner presented in due time its request for a set-off of the respective mutual debts between it and the debtor, and in the same Order wherein the District Court approved the plan of composition, it disallowed the set-off. The judgment was affirmed by the Fifth Circuit Court of Appeals in 142 Fed (2d) 1.

The Plan of Composition in Brief

Willacy County Water Control & Improvement District No. 1 is a Water Control and Improvement District organized under the laws of the State of Texas,[1] being an irrigation district created for the purpose of constructing and operating irrigation projects and works devoted to the improvement of lands for agricultural purposes.

1—Such District was created under Article 16, Section 59 of the Constitution of the State of Texas, and Art. 7880-1 to 147z, Revised Civil Statutes of Texas.

On July 30th, 1940, it presented its petition for the confirmation of a plan of composition. The petition alleged insolvency; that its indebtedness consisted of outstanding bonds, judgments and current obligations aggregating $5,591,884.00 in principal, with unpaid interest of $146,000.00. It also alleged that it had defaulted on the principal of its bonded indebtedness approximately $318,000.00. Of its bonded indebtedness, $3,726,000.00 thereof was evidenced by bonds payable to P. W. A. and not subject to the plan.

The debtor further alleges that it had procured from R. F. C. a loan of $516,000.00 to refund its indebtedness affected by the plan in the sum of $1,480,524.29, which allowed a refunding on the basis of 35c on the dollar.

On the 29th day of November, 1940, the District filed its amended plan seeking to subject thereto claims in the sum of $14,297.58, which included that of petitioner, payable out of the Maintenance and Operation fund of the District.

Petitioner's claim was set up by the debtor as belonging to W. A. Harding. W. A. Harding filed a Disclaimer on December 14th, 1940, setting up that he did, on the 6th day of September, 1939, assign the claim to Evergreen Farms Company. Evergreen Farms Company intervened on December 18th, 1940, setting up its ownership of the claim and asked that the amount owed by it to the debtor be set-off against said claim.

The Lower Court approved the claim of Evergreen Farms Company, disallowed the set-off and subjected the claim to the plan, whereby petitioner should receive 35c on the dollar for said claim. This judgment was affirmed by the Fifth Circuit Court of Appeals.

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT

I

(a) **The Circuit Court held in this case that the right of set-off provided for in Section 68 of the Bankruptcy Act is inapplicable to proceedings under Chapter IX of the Bankruptcy Act (Municipal Bankruptcy Act) even though a plan of debt revision is approved and consummated in such proceeding. This decision is in sharp conflict with decisions by this Court in the Cumberland Glass Company case (237 U. S. 447) and the Lowden case (298 U. S. 160).**

(b) The Cumberland Glass Company case established the right of set-off under Section 68 in composition proceedings.

(c) In the Lowden case, the late Mr. Justice Cardoza reserved the question of the right of set-off in proceedings for reorganization, yet strongly inferred that upon a distribution of the assets, or "the analogous stage of revision of the debt" an offset under the statute would be proper. There was certified to the Supreme Court in the Lowden case, among others, the question "Does the right of set-off recognized by Section 68 (a) of the Bankruptcy Act apply to reorganization proceedings under Section 77 of that Act?" The Court held the question insufficient as being too general, stating in part, "One must see the controversy in its setting before the implication of a ruling can be prefigured with assurance." The Court stated, however, as follows:

> "From the fact without more that such a proceeding has been initiated, one cannot know that it will be necessary to have recourse to Section 68, 11 U. S. C. A., 108, which was meant in its enactment to prescribe the rule of set-off upon a distribution of the assets. That stage of administration, **or the analogous stage of the revision of the debts,** may never be attained in a proceeding to reorganize, though a petition has been approved and trustees have been appointed." (Bold face furnished).
>
> "If a plan of reorganization is not proposed or accepted, or, being proposed and accepted, is not confirmed by the Court within a reasonable time, the whole proceeding may be dismissed, (Sec. 77 (c) (7), 47 Stat. 1476); the title to the estate thus reverting to the debtor."

(d) In this case a debt revision was authorized and consummated contemporaneous with the disallowance of the set-off. (R-185). No appeal is pending which directly attacks the approved plan itself.

(e) The decision also conflicts with that of the Seventh Circuit Court of Appeals in In re: Rosenblum Grain Corporation (103 Fed. (2d) 656, 658) which cites with approval the Cumberland Glass Company case, and also conflicts with the decision of the Tenth Circuit Court of Appeals in Henry vs. Dolley (99 Fed. (2d) 94), in both of which cases it is held that the right of set-off under Section 68 of the Bankruptcy Act exists even in reorganization proceedings under Section 77 of the Act.

A portion of the opinion in the Rosenblum case being as follows:

> "On April 23, 1935, the debtor filed its voluntary petition for corporate reorganization under Section 77 (b) of the Bankruptcy Act, 11 U. S. C.

A., Sec. 207. The District Court then ordered the grain and stock accounts here in question closed. After the close-out, this situation remained: the claimants had on their books a balance belonging to the debtor; the debtor had on its books a balance belonging to the claimants. Therefore, at the proper time, each claimant filed as his claim against the debtor an amount equal to the difference between the balances in the respective accounts. The trustee objected to each claim on the ground that the resulting off-set lacked mutuality. The District Court, however, allowed the offset under Section 68 (a) of the Bankruptcy Act." * * *

"The necessary mutuality existed, and the balance in the respective accounts were properly set-off one against the other."

II

(a) **The holding of the Circuit Court that Chapter IX of the Bankruptcy Act was a separate law to itself, and not therefore subject to the general provisions of the Bankruptcy Act, is untenable and is in conflict with the great weight of authority, and particularly in conflict with the decision of this Court in U. S. vs. Bekins (304 U. S. 27, 58 S. Ct. 811) and with the cases therein cited.**

(b) In the Bekins case the Court stated that "It is well settled that a proceeding for composition is in its nature within the federal bankruptcy power. Compositions were authorized by the Bankruptcy Act of 1867, Sec. 43, 14 Stat. 538, as amended by the Act of 1874, c. 390, Sec. 17, 18 Stat. 192. It is unnecessary to the validity of such a proceeding that it should result in an adjudication of bankruptcy." The Court quoted from its previous decision in Continental-Illinois Bank and Trust Company vs. Chicago Rock Island Railroad Company (294 U. S. 648, 673, 55 S. Ct. 595, 79 L. Ed. 1110), to the effect that compositions under the Bank-

ruptcy Act "Was there sustained upon the broad ground that the 'Subject of Bankruptcies' was nothing less than 'the subject of the relations between an insolvent or non-paying fraudulent debtor and his creditors, extending to his and their relief'."

III

The Circuit Court has decided in this case an important and far reaching question of law which has not been, but should be, settled by this Court. This decision being that the right of set-off in composition proceedings under Chapter IX is not controlled by the general laws of bankruptcy, but "is controlled by Chapter IX dealing with municipal corporations."[1] This is true in view of the tremendous number of suits being filed and now pending under the Municipal Bankruptcy Act, and in view of the fact that in 95% of such cases in which debts payable out of the Maintenance and Operation funds of the debtor, the question of set-off will arise. It being borne in mind that the Maintenance and Operation fund of a municipality, such as Appellant, is not derived from taxation, but rather from water assessments, water charges and rents, and is used only for the purpose of paying current obligations of the municipality and cannot be used to discharge its bonded indebtedness.

IV

The Circuit Court's holding that the Lower Court properly disallowed the set-off in this case, because to allow the same would constitute a preference in favor of Evergreen

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1—Quoted from the Opinion, 142 Fed. (2d) 1.

Farms Company, was against established law, and contrary to the decision of the Sixth Circuit Court of Appeals in Prudential Insurance Company of America vs. Nelson (101 Fed. (2d) 441) and the decision of this Court in Scott vs. Armstrong (146 U. S. 499, 12 S. Ct. 148). In the latter case the Court stated "Where a set-off is otherwise valid, it is not perceived how its allowance can be considered a preference, and **it is clear that it is only the balance, if any, after the set-off if deducted, which can justly be held to form part of the assets of the insolvent."** (Bold face furnished)

The Sixth Circuit Court held in the Prudential Insurance Company case in part as follows:

> "In all cases of mutual debts, where the insolvency of one of the debtors and the rights of the the other creditor in the assigned estate are involved, equity intervenes and modifies the legal right of set-off in order to promote equality and Justice. Compare Scott vs. Armstrong, 146 U. S. 499, 513, S. Ct. 148, 36 L. Ed. 1059; Western Power Mfg. Co. vs. Brewerton Coal Co., 7 Cir. 81 Fed. (2d) 85; Standard Oil Company of New Jersey vs. Elliott, 4 Cir., 80 Fed. (2d) 158; Hood vs. Brownlee, 4 Cir., 62 Fed. (2d) 675."

There was no dispute in this case that, at the time of the filing of the petition in bankruptcy, there were mutual debts existing between Evergreen Farms Company and the bankrupt. The Creditor, Evergreen Farms Company, was indebted to the respondent for water charges and assessments in the sum of $7,019.66, (R-30) and the debtor was indebted to Evergreen Farms Company at such time in the sum of $4,797.74, as found by the District Court (R-187).

Thus, the question is squarely put as to whether or not, under the Municipal Bankruptcy Act, where there are mu-

tual debts existing between the bankrupt and its creditors at the time of the filing of the bankruptcy petition, and where an actual debt revision is accomplished, the Court should set-off the respective debts as provided for in Section 68.

This Court should likewise take jurisdiction of this case in order to correct the error appearing on the face of the opinion of the Circuit Court of Appeals to the effect that the matter of set-off "is controlled by Chapter IX dealing with Municipal Corporations, rather than by general provision of the Bankruptcy Act", there being no provision in Chapter IX either allowing or disallowing the right of set-off. Chapter IX being merely an amendment to the general laws of bankruptcy.

WHEREFORE, your petitioner prays that a Writ of Certiorari issue under the seal of this Court directed to the Circuit Court of Appeals for the Fifth Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of said Circuit Court, had in the case numbered and styled on its docket "No. 9954, Evergreen Farms Company, a partnership, etc. et al, Appellant, versus Willacy County Water Control & Improvement District No. 1, Appellee", to the end that this cause may be reviewed and determined by this Court as provided for by the Statutes of the United States; and that the judgment herein of said Circuit Court be reversed by the Court, and for such further relief as to this court may seem proper.

Dated March 30, 1942.

D. F. STRICKLAND, Mission, Texas
Counsel for Petitioner

Of Counsel:

ORVILLE I. COX

McAllen, Texas

FILED
MAY 7 1942
CHARLES ELMORE CROPLEY
CLERK

No. 1123

Supreme Court of the United States

EVERGREEN FARMS COMPANY,
Petitioner,

v.

WILLACY COUNTY WATER CONTROL & IMPROVEMENT DISTRICT NO. 1,
Respondent.

ANSWER TO PETITION FOR WRIT OF CERTIORARI

JOHN D. MCCALL,
SAWNIE B. SMITH,
MILLARD PARKHURST.
Attorneys for Respondent.

SAWNIE B. SMITH,
Edinburg, Texas.

JOHN D. MCCALL,
Kirby Building,
Dallas, Texas.

MILLARD PARKHURST,
Kirby Building,
Dallas, Texas.

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v.

WILLACY COUNTY WATER CONTROL & IMPROVEMENT DISTRICT NO. 1,

Respondent.

ANSWER TO PETITION FOR WRIT OF CERTIORARI

This is a proceeding under Chapter IX of the National Bankruptcy Law. The Trial Court refused to allow the set-off claimed by the Petitioner for the writ of certiorari and such action was affirmed by the Circuit Court of Appeals.

The Petitioner for the writ charges that the decision of the Circuit Court of Appeals is erroneous and is in conflict with the following cases:

Cumberland Glass Mfg. Company v. DeWitt, 237 U. S. 447;

Lowden v. Northwestern National Bank & Trust Company, 298 U. S. 160.

We submit that the decision of the Circuit Court of Appeals in this case is not in conflict with the two cases just cited.

The *Cumberland Glass Company case* involved the question of whether Section 68 of the Bankruptcy Act (author-

izing set-offs) applied in a bankruptcy proceeding involving the estate of Charles DeWitt & Company, during the course of which proceeding a composition of the indebtedness was proposed and confirmed. Such composition was proposed and accomplished under Section 12 of the act which affects only private debtors and was enacted long before the Municipal Compositions Act now comprising Chapter IX. Compositions under Section 12 may be had in the course of a bankruptcy case theretofore instituted and if the plan is confirmed the case is dismissed, but if the plan is not confirmed the estate must be administered as provided in the Bankruptcy Law. Obviously there is no similarity between this provision of the General Bankruptcy Law and the Municipal Compositions Act. Nevertheless, the Court held that Section 68 *is permissive rather than mandatory.*

The *Lowden case* was a reorganization proceeding by a railroad company under Section 77 of the Bankruptcy Law wherein the Circuit Court of Appeals certified to the Supreme Court the abstract question of whether Section 68 (allowing set-offs) was applicable to proceedings conducted under Section 77. The Supreme Court declined to answer the question because the question and the statement certified were insufficient to apprise the Court as to whether the set-off should be allowed or disallowed under the facts in that particular case, and the Court further declined "to put the law [Section 68] into a straight jacket by subjecting it to a pronouncement of needless generality." In other words, the Supreme Court declined to say whether Section 68 was applicable to a Section 77 proceeding, but if it is applicable it is clear from the opinion that *its application*

would depend entirely upon the facts and the justice of each particular case.

In the case now before the Court, the Trial Court held that under the facts, the Petitioner for certiorari was not entitled to a set-off. In addition to the opinion of the Circuit Court of Appeals, very little need be said concerning the justice of the decision of the Trial Court, but the record might be summarized briefly as follows:

> W. A. Harding was scheduled as a creditor of the insolvent district; Harding filed a disclaimer and alleged that he had assigned his claim to a partnership (Evergreen Farms Company), consisting of himself and some others; the partnership filed a protest to the plan alleging that it owed the insolvent district some money and asking that the claims be set-off.
>
> The District did not know of the assignment until after the Reconstruction Finance Corporation made the refinancing loan; until after the plan of composition had been adopted, amended, submitted to the creditors and $1,376,000.00 of bonds purchased by the Reconstruction Finance Corporation; and until after a writ of garnishment had been served seeking to garnish money which the District thought it owed W. A. Harding. (R. 28; 175; 121; 145; 209; 161.)
>
> The accounts which the Evergreen Farms Company partnership attempted to set-off were not charged by the District to the partnership but to various individuals, most, but not all of whom were members of the partnership. (R. 30.)
>
> The principal part of the revenues from which the Harding claim was payable had been pledged theretofore for the payment of bonds held by the United States Government. (R. 56; 58.)

Even though the assignment from Harding to the Partnership was in the utmost good faith (evidence to the con-

trary would seldom be available) such fact would not justify a set-off provision in the Plan of Composition because it would give Harding and his Partnership an unfair advantage over other creditors who did not and could not sell their claims to partnerships of which they were members and which owed money to the District.

As to the applicability of Section 68 to Municipal compositions under Chapter IX, it is significant to note the following:

(a) When Congress enacted the Corporate Reorganization Law (now Chapter X) it specifically adopted the provisions of Chapters I to VII, inclusive, *which include Section 68*. See Section 102;

(b) When Congress enacted Chapter XI on "Arrangements" it specifically adopted the provisions of Chapters I to VII, inclusive, which include Section 68. See Section 302;

(c) When Congress enacted the Municipal Compositions Act (now Chapter IX) it did not adopt the provisions of any other part of the National Bankruptcy Law.

Summary

Our entire position may be summarized as follows:

1. Section 68 of the General Bankruptcy Law is not applicable to municipal compositions had under Chapter IX.

2. If, however, Section 68 should be applicable, then it is permissive and not mandatory so that a set-off should be allowed or disallowed according to the facts and the justice

in each particular case, and in this particular case, we submit that the facts and the justice required that the set-off be disallowed, as was done by the Trial Court.

Respectfully submitted,

JOHN D. MCCALL,

SAWNIE B. SMITH,

MILLARD PARKHURST.

Attorneys for Respondent.

SAWNIE B. SMITH,
Edinburg, Texas.

JOHN D. MCCALL,
Kirby Building,
Dallas, Texas.

MILLARD PARKHURST,
Kirby Building,
Dallas, Texas.